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INTERLOCKING DIRECTORATES

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MR. CHAIRMAN, LADIES AND GENTLEMEN: Mr. Wilcox, in his interesting paper, has laid down certain fundamental planks, which should govern the adjustment of relations between the community and privately owned public service corporations. But as Mr. Taylor has indicated those fundamental planks should rest upon justice. And justice can only be attained by a careful regard for fundamental facts; since justice is but truth in action. What those fundamental facts are has been suggested in the very informing paper which Mr. Palmer has just read. They are primarily: (1) the facts relating to the cost of the plant, and (2) the facts relating to the cost of operation. We must have, in order to ascertain those facts, knowledge that is not only accurate, but comprehensive. The instances which he gave, notably the data in regard to nitrogen lamps, show that facts, in order to be useful, must also be up-to-date. As Matthew Arnold said: "Erroneous decisions are more often due to lack of recent information than to errors in reasoning."

Mr. Palmer has also pointed out most clearly how such comprehensive information is to be obtained. It can be done only through a properly equipped bureau; and that bureau must work in coöperation with all those interested. Such coöperation has, in the past, existed and very properly between the public utilities companies. These have long had their associations, and the associations have no doubt aided greatly in promoting the efficiency and prosperity of the separate organizations. But the communities served have hitherto had no means of coöperation. The Utilities Bureau recently inaugurated by mayors of great cities will furnish the instrument through which coöperation of municipalities may become effective. It points the way to efficiency and to justice and must prove of great benefit to all American cities.

But in addition to providing means for ascertaining facts and for disseminating the knowledge gained, it is necessary to establish conditions under which the machinery of the Utilities Bureau can

operate efficiently. We must in other words have conditions consistent with the ascertainment and appreciation of the truth.

In connection with these public utility problems, there is much talk about stock watering. To my mind the real objection to stock watering is not that those who enter upon these enterprises get too large a return. Mr. Guernsey is entirely right in saying that those who put their money into public utility projects should receive as large a return as in other business enterprises involving a like risk. For capital, risk and ability applied to public service corporations must be paid for at market rates. The public interest demands that the rewards should be adequate; otherwise the requisite capital, zeal and ability cannot be secured. My objection, therefore, to stock watering is not that men have thereby obtained in many instances a very large return, but that stock watering tends to obscure the truth. It hides the actual facts as to the amount invested. No doubt promoters of enterprises have often resorted to stock watering for the purpose of misleading the general and the investing public; but in a very large number, perhaps in most cases, the motive has been mistrust of the public. That is, the stock watering device was resorted to because promoters believed that the public would not, if the actual facts were known, allow a just return; because (if the enterprise proved successful) they would ignore the risks which had been taken. Of course the risk incurred is a most important element in determining what the return upon an investment should be. With the establishment of the Utilities Bureau which can authoritatively supply the facts to the public, much of the incentive for stock watering would be removed.

There is another corporate practice which also tends to obscure the truth: interlocking directorates. They are an obstacle to knowledge of fundamental facts, because the existence of the interlocking robs an enterprise of those conditions which under the general laws of business ordinarily lead to the ascertainment of true values. Ordinarily in business the value of a thing or service is determined through the agreement reached by an intelligent seller and an intelligent purchaser—each looking out for his own interest to the best of his ability. Where interlocking directorates or other conflicting interests exist, this protection is lost.

The first step in any enterprise, after it is planned, is the getting of money. Under interlocking directorate practice, the same man

acting as banker sells to himself acting as the public utilities corporation the money with which that corporation is to be established. Then that same man, acting as public utilities corporation, buys from himself, acting as electrical manufacturer, the apparatus which is to be used. Then the same man, having thus bought the apparatus as public service corporation, contracts with himself acting as construction company for the building of the plant. Then the same man, having completed the construction of his plant, and being ready as public service corporation for business, contracts with himself as supply house, for the supplies. And finally this same man, having gotten ready for business as public service corporation, enters into a special contract for power with himself as manufacturer. Now, it is obvious that if the fundamental basis of business is correct, there should be in every trade two sides; men should deal with each other at arm's length; and what are the best prices, what are the best results should be determined by the exercise of two independent minds representing the conflicting interests. The old law that "No man can serve two masters" properly is as applicable today as it was twenty centuries ago.

There is another reason why interlocking directorates must be abolished: namely, the demands of efficiency. Obviously the only justification for the director's existence is that he should direct; which means that he should be an absolutely fair and intelligent adviser and critic of the enterprise. The men who are in charge of an enterprise as executive officers are supposed to manage, and to possess the required energy and determination to go forward. But in a well equipped organization there should be men who will check up the manager's judgment and performance. Only in this way can continued prosperity be assured.

For the proper exercise of the functions of director, it is essential that he be disinterested; that is, be free from any conflicting interest. But it is also essential that he have knowledge. Facts, facts, facts, are the only basis on which he can properly exercise his judgment. It is as necessary that he know intimately the facts concerning the business, as that he have only one interest to subserve. Now, no man can have such detailed knowledge of the facts of many enterprises. This is due to the limitations of time and place and to those other limits set by nature upon human intelligence. How can one man know in respect to many large corpor-

ations the facts which a director needs to know in order to insure efficient management? Though improper motives contributed to the New Haven tragedy, the main cause of the stockholders' misfortune appears to have been the directors' ignorance; and this ignorance was no doubt largely due to the fact that the same men who were its directors held like offices in a multitude of other corporations.

If there were no other reasons against the practice of interlocking directorates the demands of efficiency alone would call for its abolition. But there are other reasons; and there is one other reason which has broad application here. It is this: We must have not only a knowledge of facts, as a basis for doing justice; but we must have conditions under which truth may properly function. We must seek to isolate truth so as to free it from the operation of those forces which would cause a deviation from the true path. Such forces operate sometimes through compulsion, sometimes through influence. We cannot expect to have justice done unless we have a mind that is free to act on such facts as may be presented. We must, therefore, to secure just dealings with public service corporations, see to it that there does not arise in the community affected conditions by which those representing the public are consciously or unconsciously warped in their judgment.

To my mind the gravest objection to the practice of interlocking directorates is that it has created financial power so great that even the best men have found themselves unduly influenced. Such undoubtedly was true in respect to many of the New Haven's operations. There through the interlocking of banks, bankers, insurance and trust companies, railroads, steamship lines, public service corporations, equipment and other manufacturing companies, a power was created so great that the intelligence, will, and character of individuals were powerless to resist it.

What shall we do to meet this situation? Congress, in the Clayton Act, recently passed, has indicated one of the things that should be done. It has declared that the practice of railroads, in purchasing, whether it be money or supplies, or construction, or any other of the elements entering into the building and operation of its properties, from concerns in which its own officers or directors or purchasing agents are concerned, shall cease; and the law makes such transactions a misdemeanor, excepting in those instances when

they are trifling in the aggregate, or where the transaction is effected upon competitive bids and under a condition prescribed by the Interstate Commerce Commission, under rules which would make public all facts. The provisions in regard to this competition are such that there is little likelihood that its privileges will be availed of.

One measure to be recommended for ending interlocking directorates in public utility enterprises, is state legislation of similar character. Another is to develop and utilize the Utilities Bureau. But the great influence which results from this interlocking of relations of the financiers can be fully met only through the widespread coöperation of our municipalities. Let us meet financial combinations by municipal coöperation. When that is done, and not until then, shall we have the conditions under which justice can be done to capital and to the community alike.